MONACO ASSET MANAGEMENT

Independence, Integrity, Innovation

Market Views (29/05/20)

Financial Markets Highlights

1. The Covid-19 pandemic has shut down the global economy for months in a row. The global economic recession is the greatest in decades. The World will take a long time to heal. We expect an L-shaped economic recovery.

2. The Fiscal and Monetary support provided by Governments and Central Banks globally is unprecedented and has come early in the crisis. This will go a long way in ensuring an economic recovery down the road. That said, unemployment rates are unlikely to fall back to pre-crisis levels anytime soon. In fact, we expect unemployment rates to remain elevated for a long period of time with 40%+ of jobs lost that could potentially not be replaced soon after the economies reopen. Supply chain disruptions will last, putting upward pressure on inflation.

3. The MSCI World is -9.9% YTD. Earnings expectations for 2020 have only come down by 10-15% so far; this is too little if we compare to similar recessions in history. We expect earnings to fall c. 30% peak to trough in this cycle. From a valuation perspective, the MSCI World Index trades at record high PE valuation multiple of 20.9x. Equity markets have yet to price the long-term impact of this crisis. There is too much complacency in equity markets with data showing most of the rally is being fuelled by retail investors.

4. Credit spreads have somewhat tightened. Central Bank support will ensure we do not experience the levels of spreads widening we did in March 2020. Yet, as per equities, we believe that credit spreads are set to widen on deteriorating economic outlook and slower than expected economic recoveries.

5. The USD should fundamentally weaken as the ever-rising deficit and relative growth elsewhere take their toll. We favour the EUR and the JPY against the USD based on their relative cheapness in the medium-term.

6. Commodities remain one of our favourite asset classes. We like precious metals, and agriculture commodities as strong plays during potential inflationary macro regimes.

MAM Actions

Actions Previously Taken

1. We reduced equity exposures significantly in February and early March before the acceleration of the market sell-off. We also had minimal (in some instances none) exposure to fixed income markets. This reduced exposure to risk assets helped mitigate the market impact on portfolios.

2. We have been active trading in commodity markets, especially in precious metals. We recently reduced gold and silver exposures by 50% to crystallise the gains made this year.

3. We recommended to gain marginal exposure to Brazilian and Mexican equities through liquid ETFs. Both local currencies are trading at over 2SD cheap on a REER basis. We believe too much "bad news" are priced in. Both countries' governments and central banks have sufficient room for fiscal and monetary stimulus which should drive their currencies higher and benefit their respective risk assets.

Actions We Are Looking to Take

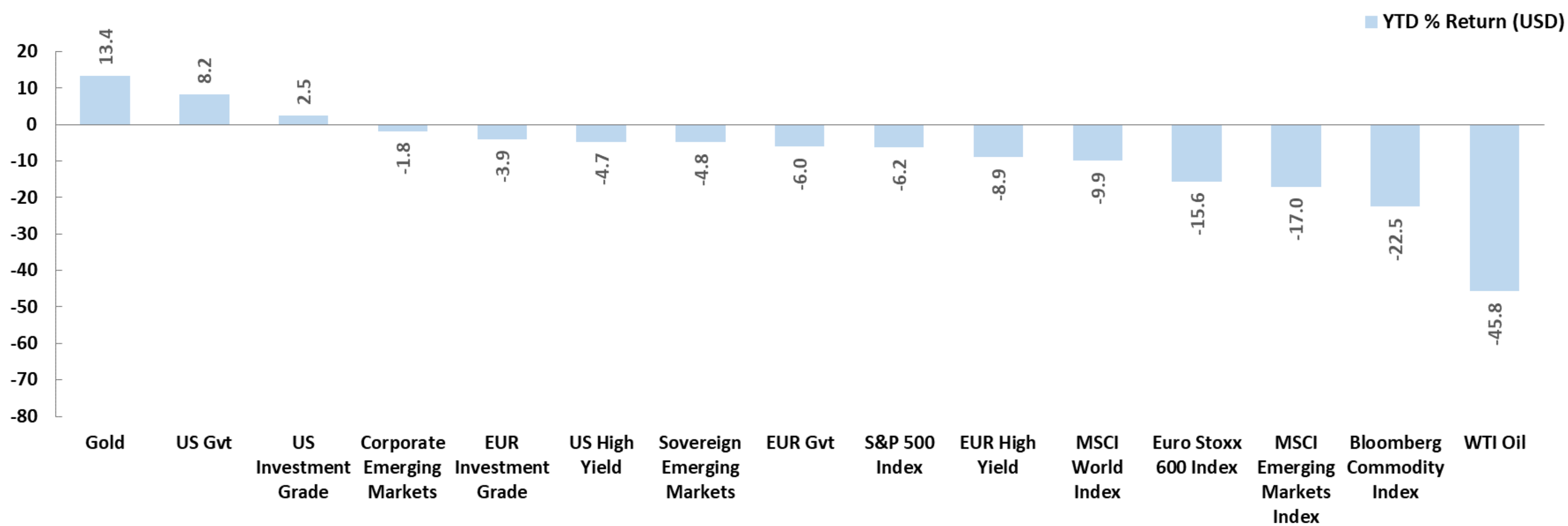
1. We intend to use the cash raised in April to buy equities in the event of a 15-20% sell-off from current levels over the next few weeks; outright equity purchases or through the sale of put options.

2. We intend to continue trading commodity markets, especially precious metals. We will buy back the exposures sold in April should prices correct 5-10% from current levels.

3. We will keep monitoring fixed income markets for opportunities especially in EUR investment grade bonds. We will also look to take advantage of potential opportunities in Emerging Markets debt.

Performance Scorecard

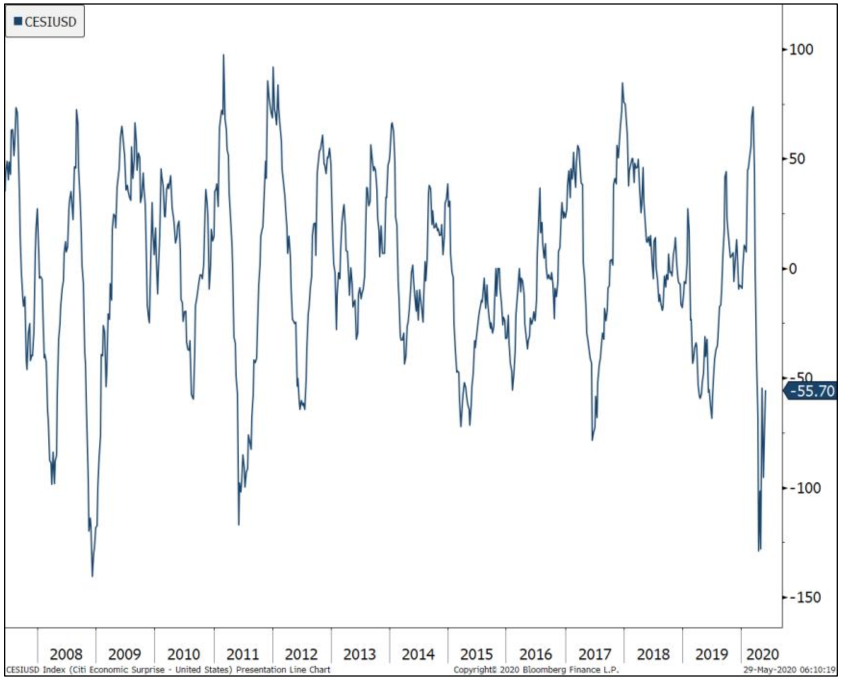
All asset classes beside Gold, and US government and IG bonds are flat or negative YTD. Very few assets have been spared by the global recession triggered by the Covid-19 pandemic. WTI oil prices are -45.8% YTD after recovering from April lows. This suggests that the recession we are currently experiencing is of historical proportion. Yet, the MSCI World Index is only -9.9% YTD. Too us, this feels and seems like an anomaly.



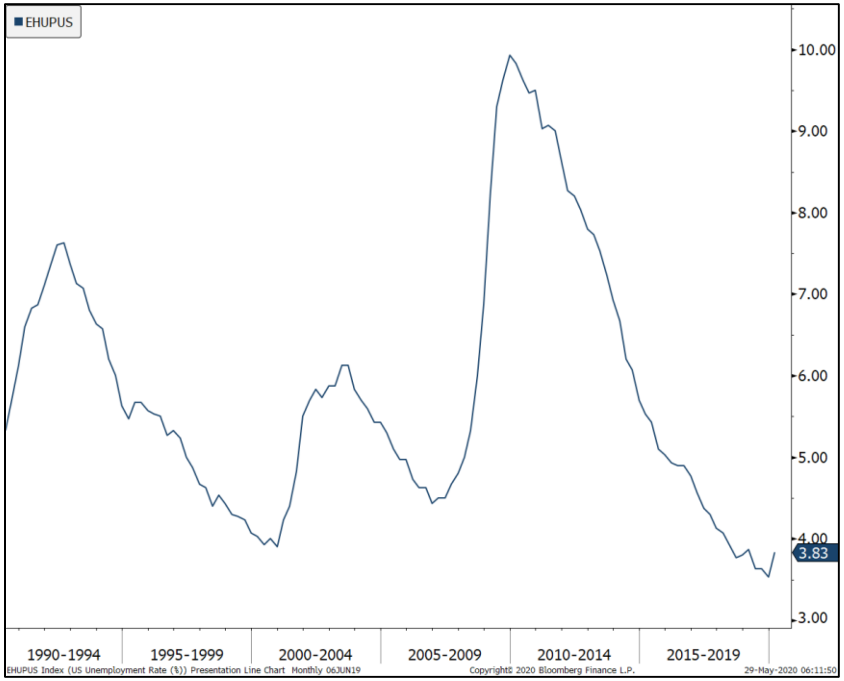
Economy

Economic data across the globe and particularly in the US has come to a trough. The Citigroup US Economic Surprise Index bottomed at 144.6, near the -148 of 2008, and now stands at -55.7. The US unemployment is set to increase as show by jobless claims numbers and the numbers should not recover as quickly as some expect. In fact, 40%+ of jobs lost could not be recovered quickly post-crisis. This secular change in trend in unemployment is likely to have lasting effects on the economy and should ultimately be more extensively reflected in financial markets.

US Economic Surprise Index

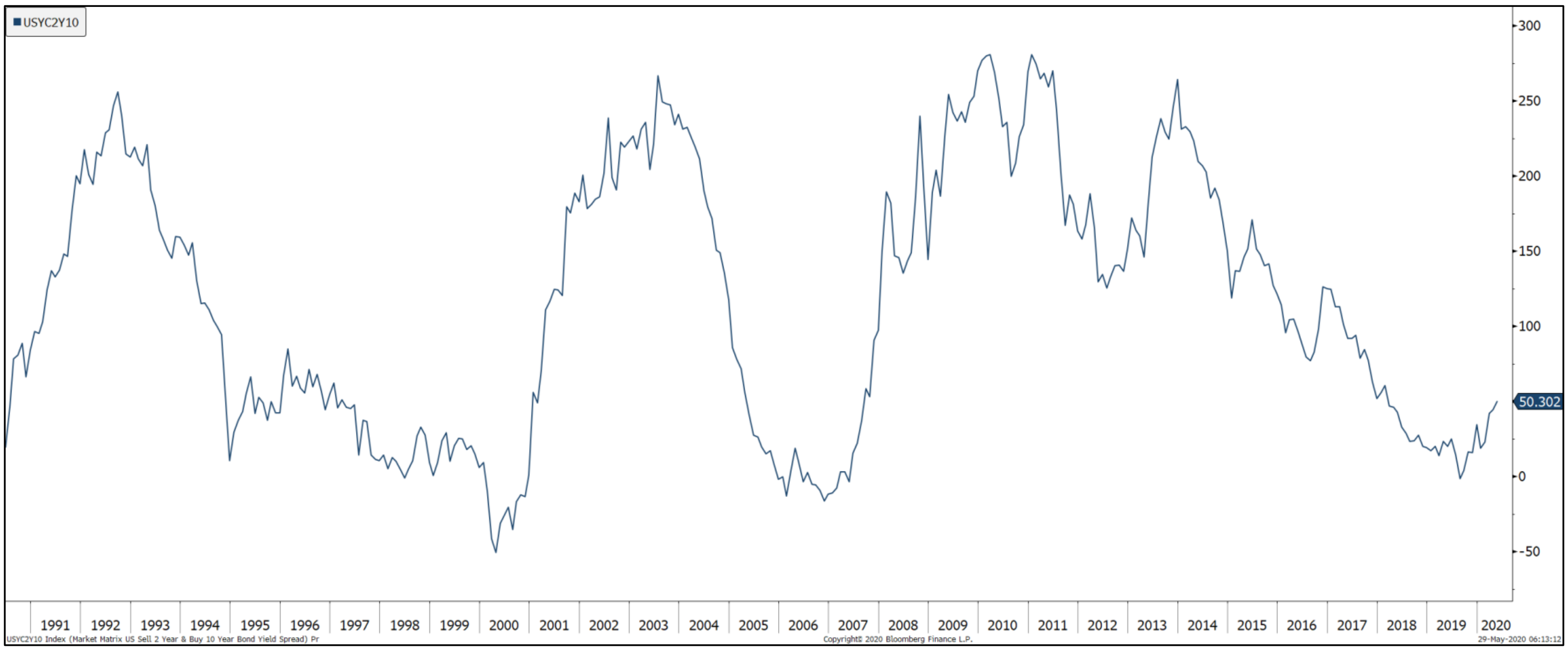


US Unemployment Rate



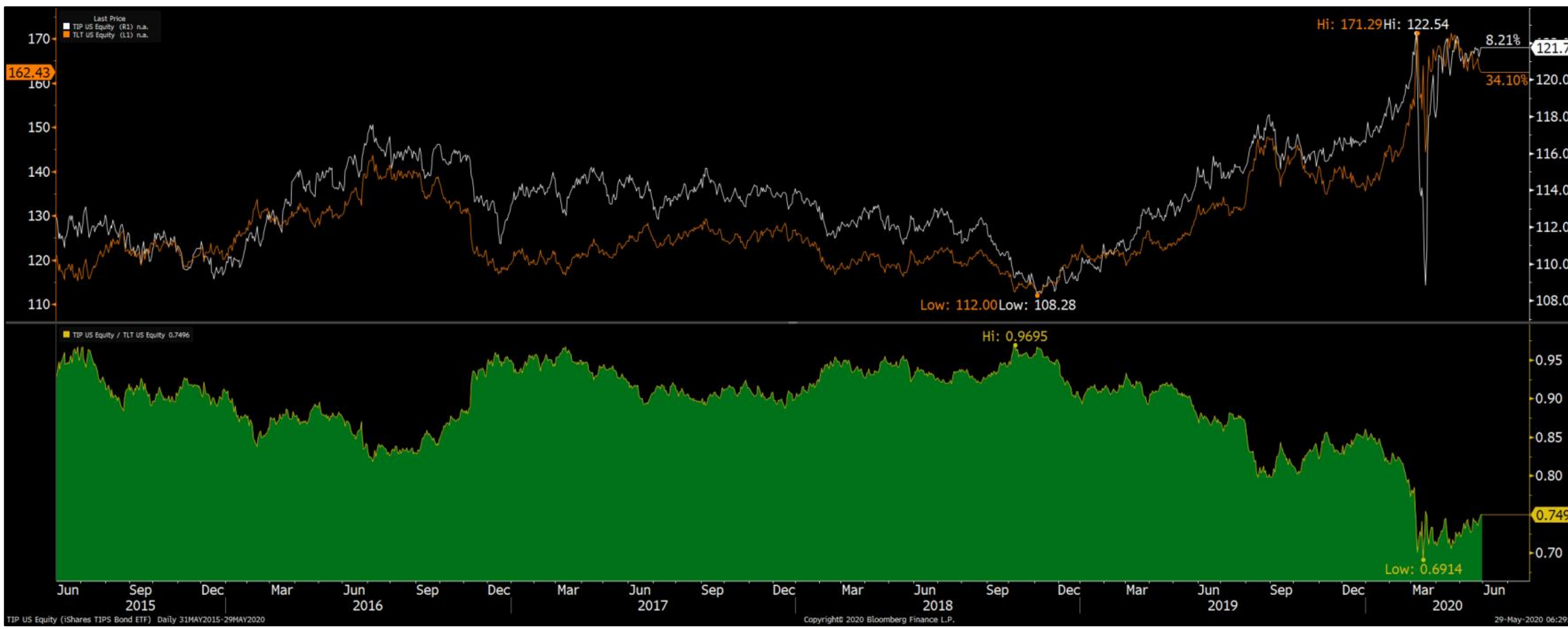
US Yield Curve Steepening

The US 2-10 yield curve has formed a base as it did in 2006/2007 just before the Global Financial Crisis bear market and are now showing some early signs of widening. The current curve steepening is likely to be telling of another equity bear market in the making.



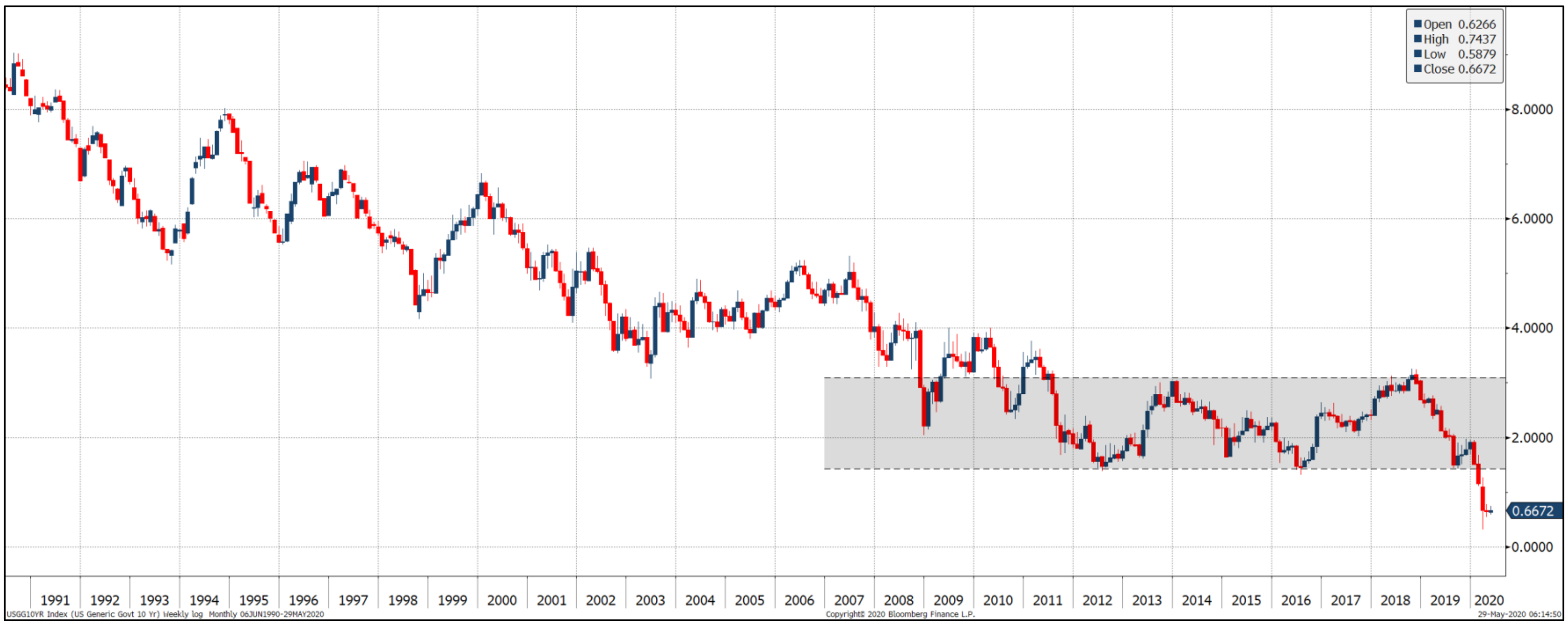
Inflation Expectations: TIPS vs TLT

Inflation expectations have stabilized. The ratio of treasury inflation protected bonds to long-term government bonds has formed a base. We believe that the monetary and fiscal policies put in place, combined with supply chain disruptions, will push inflation upward over the coming quarters.



US 10 Year Bond Yields

US 10-year bond yields have broken down through the 10-year support line of 1.5% and are currently trading at 0.67%. We believe that the large monetary and fiscal stimulus announced by the Fed can push US 10-year bond yields back to resistance of 1.5% as inflation expectations rise.

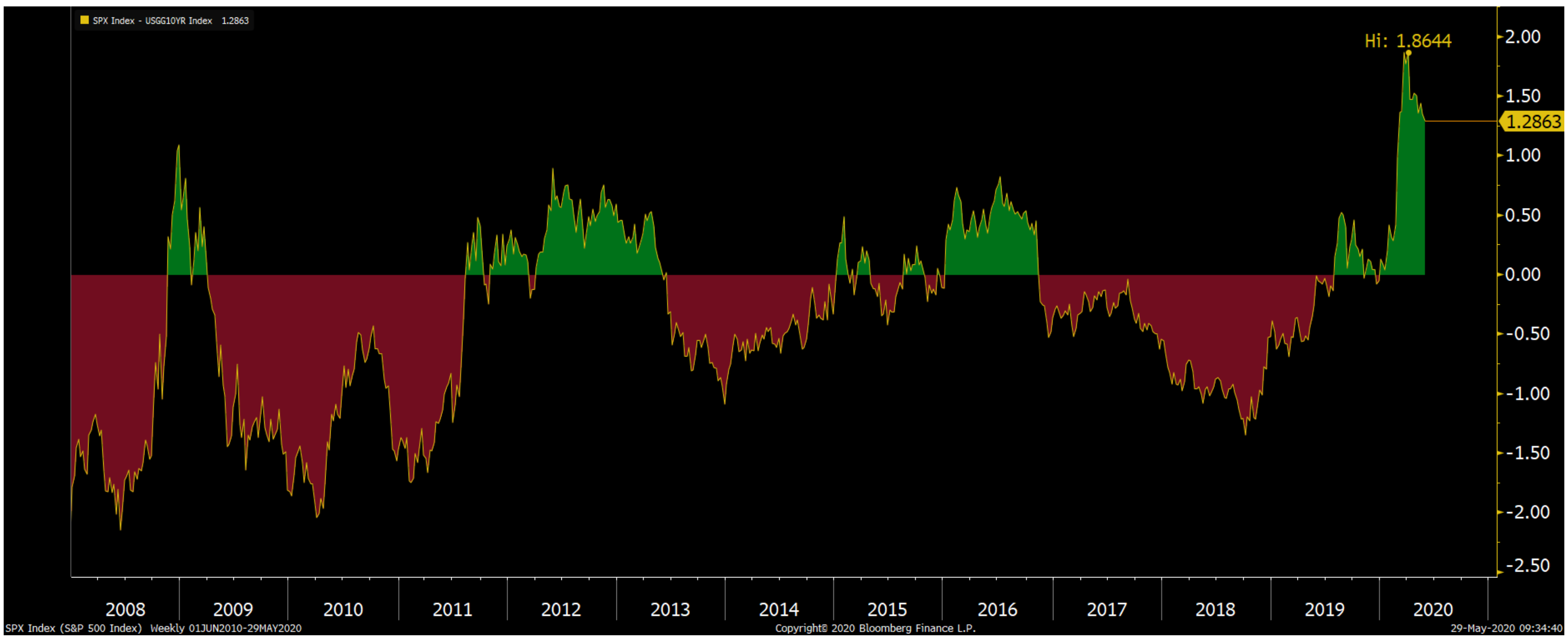


US High Yield Market

US high yield spreads have retraced just over 50% of their rise during the peak of the crisis. They remain elevated historically. While we acknowledge that Central Bank support means that spread widening to old highs is unlikely, we also think that the ongoing recession prevents spreads from tightening much further.

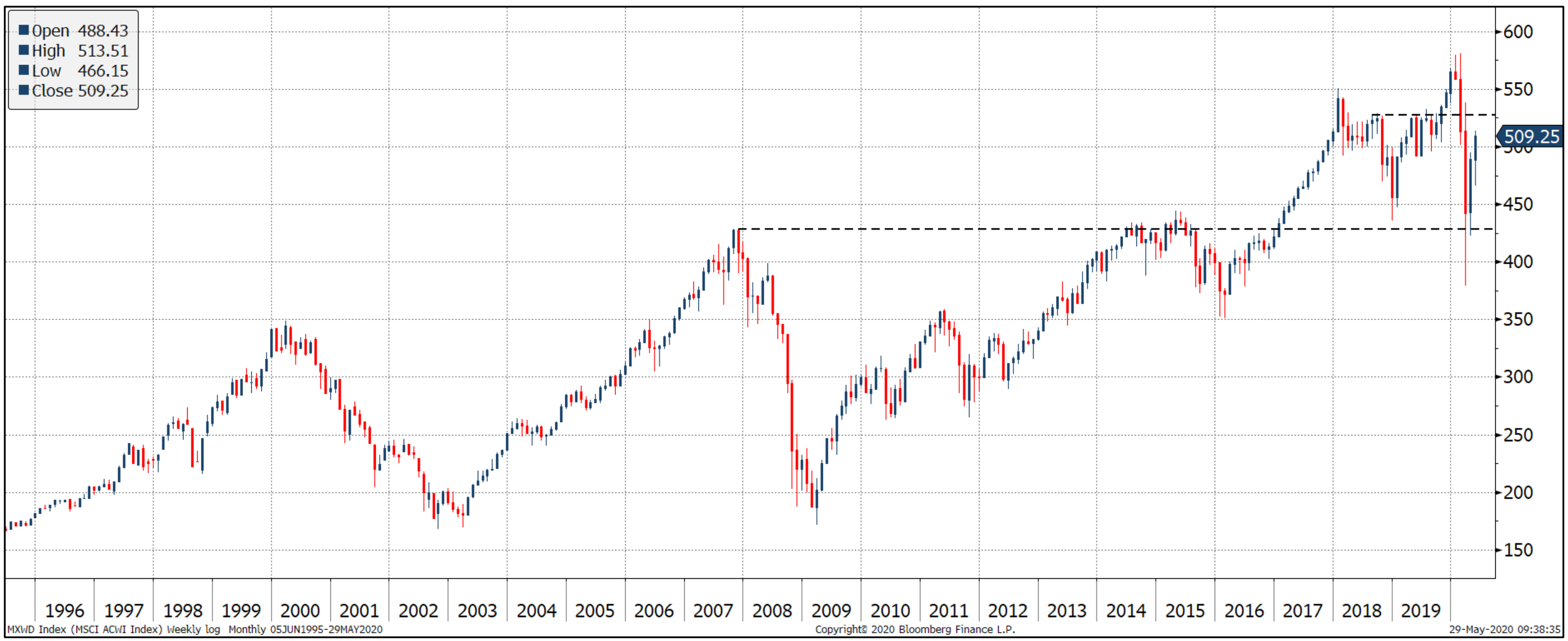
US Equities vs US Bonds

US 10-year bond yield of 0.67% is very low compared to the 1.96% offered by the S&P 500 Index. The spread between the two is greater than in 2008. This sides with the view that equities are more attractive than Government bonds longer-term. We are just not sure the actual dividend yield of the S&P 500 Index will remain as it is considering the amount of companies likely to reduce dividend distribution over the coming months just like some energy firms did following tumbling oil prices.



MSCI World Equities

Technically, the MSCI World Index has re-tested the support line of the 2007 and 2015 highs. We believe that a re-test of this level or even a re-test of the March lows is possible in the near to medium term. We also expect to see some form of technical resistance around 530, at mid-year 2018 and 2019 highs.



MSCI World Equities (PE Valuations)

The MSCI World Index is trading on a 2020F PE of 20.9x. This is 3 standard deviation expensive. While monetary and fiscal policy stimulus will drive equity valuations higher over time, we believe that a fair PE under the current recessionary environment is around long-term average of 14.6x. That means $456 target for the MSCI World assuming no change in earnings expectations.

S&P 500 Index

The S&P 500 Index found support at the 2,250 level. We believe the Index is unlikely to rally to new highs as it did in 2019. In fact, we believe that the Index will resume its downtrend in the broadening formation. A re-test of the March lows of 2,200 (-23%) or lower is a possible scenario. We advise caution in chasing the rally from over the coming weeks with a number of indicators showing and excess optimism in risk assets.

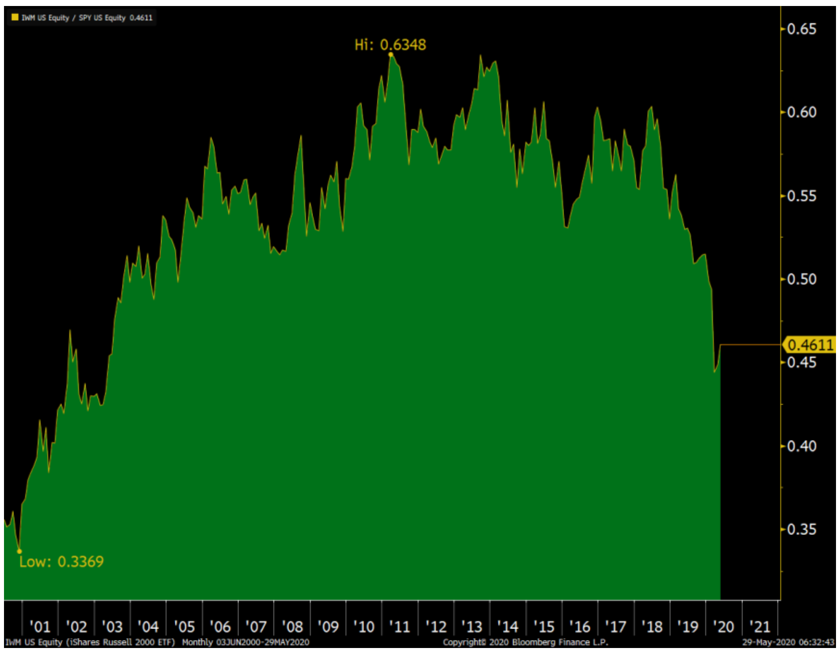
Nasdaq Index

The Nasdaq Index uptrend is intact. It found support around the 2018 lows of 7,000. The tech sector contributed extensively to the rally with investors seeking refuge in SaaS and e-commerce firms.

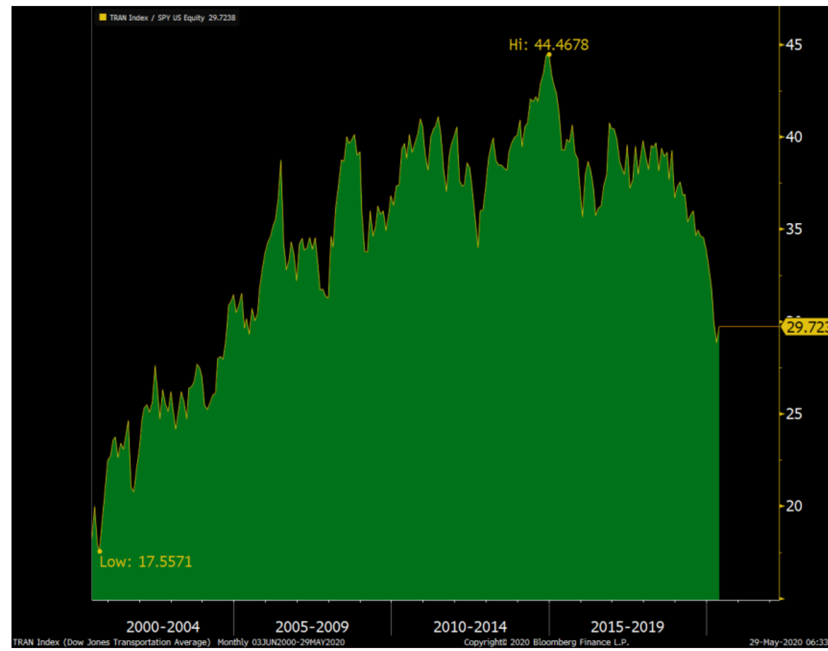
US Market Internals

US Small Caps and the Transport index are underperforming the broader S&P 500 Index. This suggests that the US economy is really deteriorating fast. We need to see a stabilization in these ratios to call for a market bottom. This is not the case yet.

Small Cap Index vs S&P 500 Index



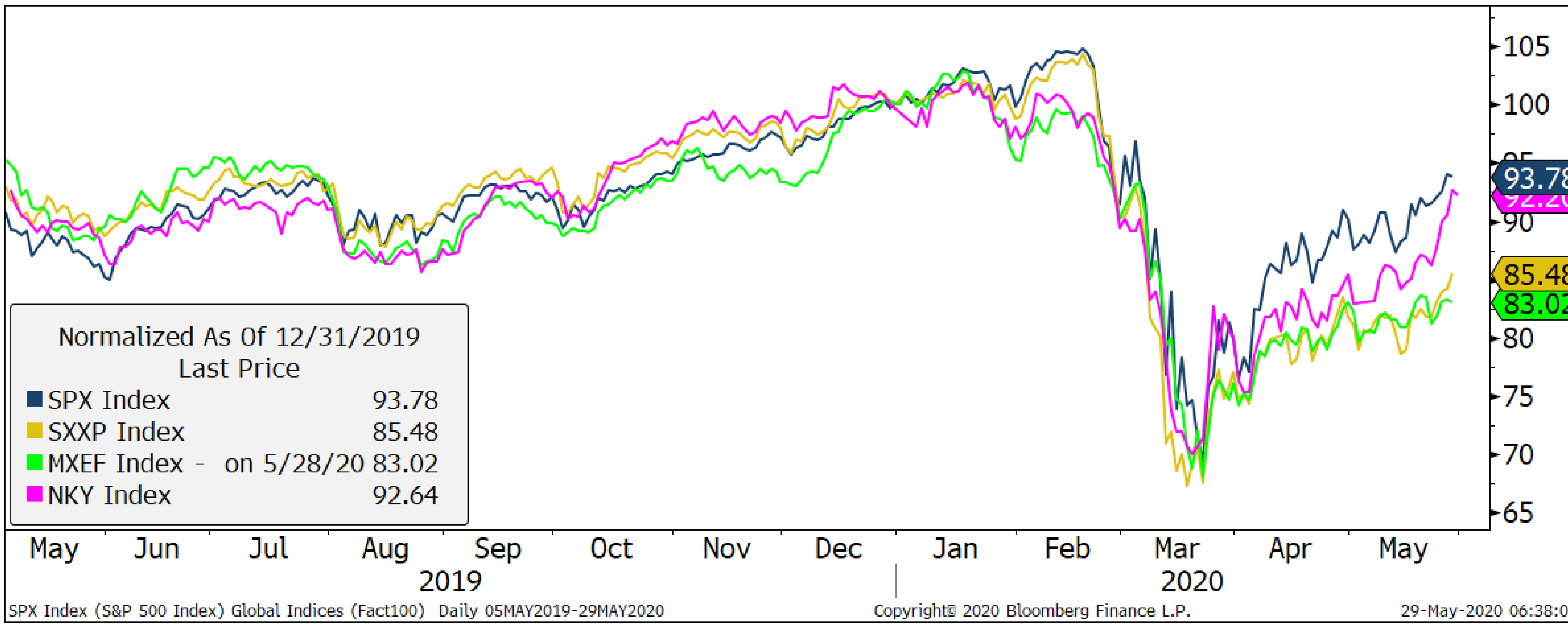
Transport Index vs S&P 500 Index



Global Equity Markets

US equity markets are still leading the pack. Europe and EM are the worst performers YTD. Japan equities witnessed a swift rally in recent weeks.

Europe (Yellow), EM (Green), Japan (Pink), US (Blue)

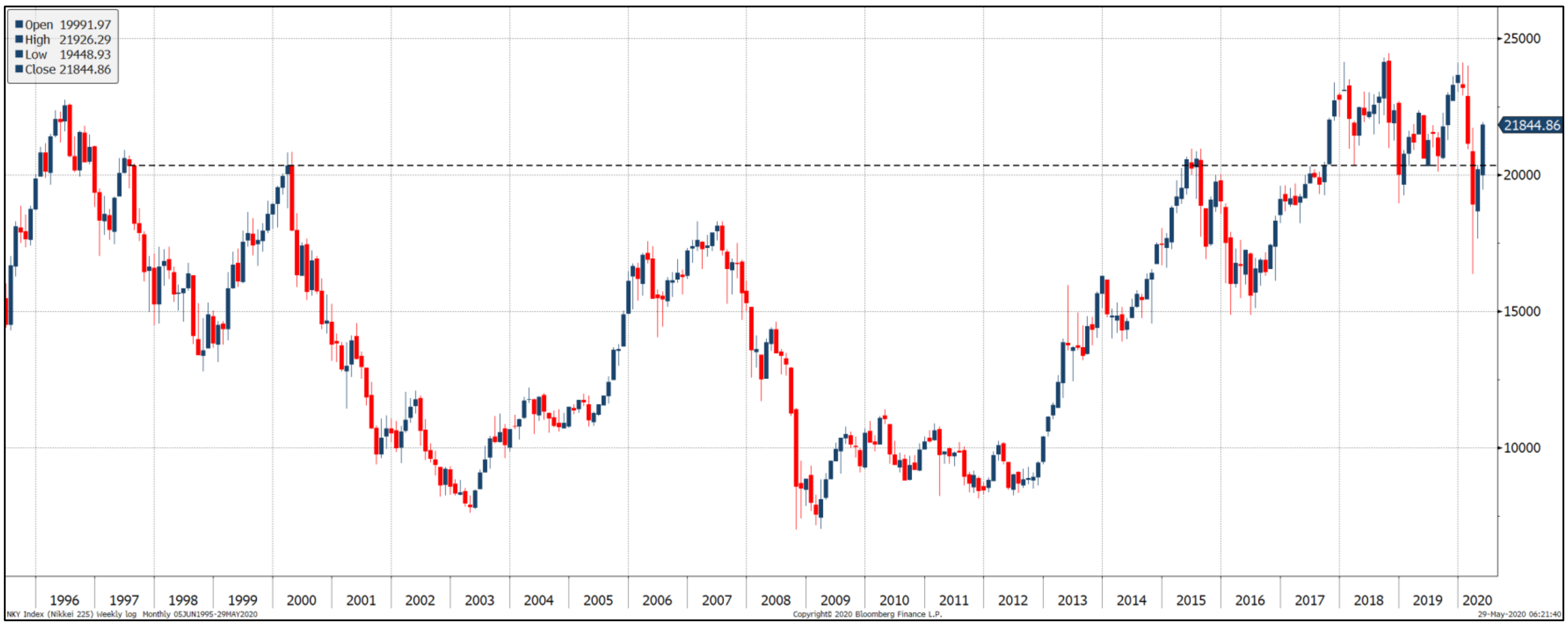


Euro Stoxx 50 Index

The Euro Stoxx 50 Index has broken above through the psychological resistance level of 3,000. While a relief rally may push it to test the next technical resistance at 3,200, there is a strong probability of a sell-off towards recent lows of 2,500 (-19%) in spite of the stimulus packages being implemented.

Nikkei 225 Index

The Japanese Equity market has broken through the previous resistance of 20,000. We see 22,000 as the newest resistance level. A retest of 20,000 is a likely outcome in the coming months. With the risk profile skewed to the downside here, we advise caution.



China A Shares Index

The Chinese A shares market is still in a 20-year uptrend for now. It is one of the most resilient equity markets globally this year.

Emerging Market Equities

Emerging Market equities are bouncing up from the 15-year uptrend. A re-test of 800 is possible (-11%) but clearly this is an asset class we are technically more comfortable buying in further weakness.

USD Index

The USD index is testing the upper-end of a generational wedge formation. We believe that a reversal towards 95 is possible in 2020 (-5%). We are comforted by the recent of currency and the continued strength of the upper-end of the wedge in recent weeks.

EUR/USD

The EUR/USD exchange rate is testing the uptrend initiated 20 years ago. We believe that it will find support around here and gradually move back towards 1.15-1.20.

Bloomberg Commodity Index

Commodities have broken down to new 40-year lows. After the acceleration lower, commodities have room to see prices rallying again. We are focusing on Energy and Agricultural commodities as candidates for a rebound.

Gold

Gold is continuing its ascent towards the 2011-2012 highs of $1,850 (+7.6%). We believe they represent a reasonable target for gold prices in 2020.

Silver

Silver prices have found support at the long-term level of $13. We continue to believe a rally towards $20 (+14.9%) is possible in 2020.

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